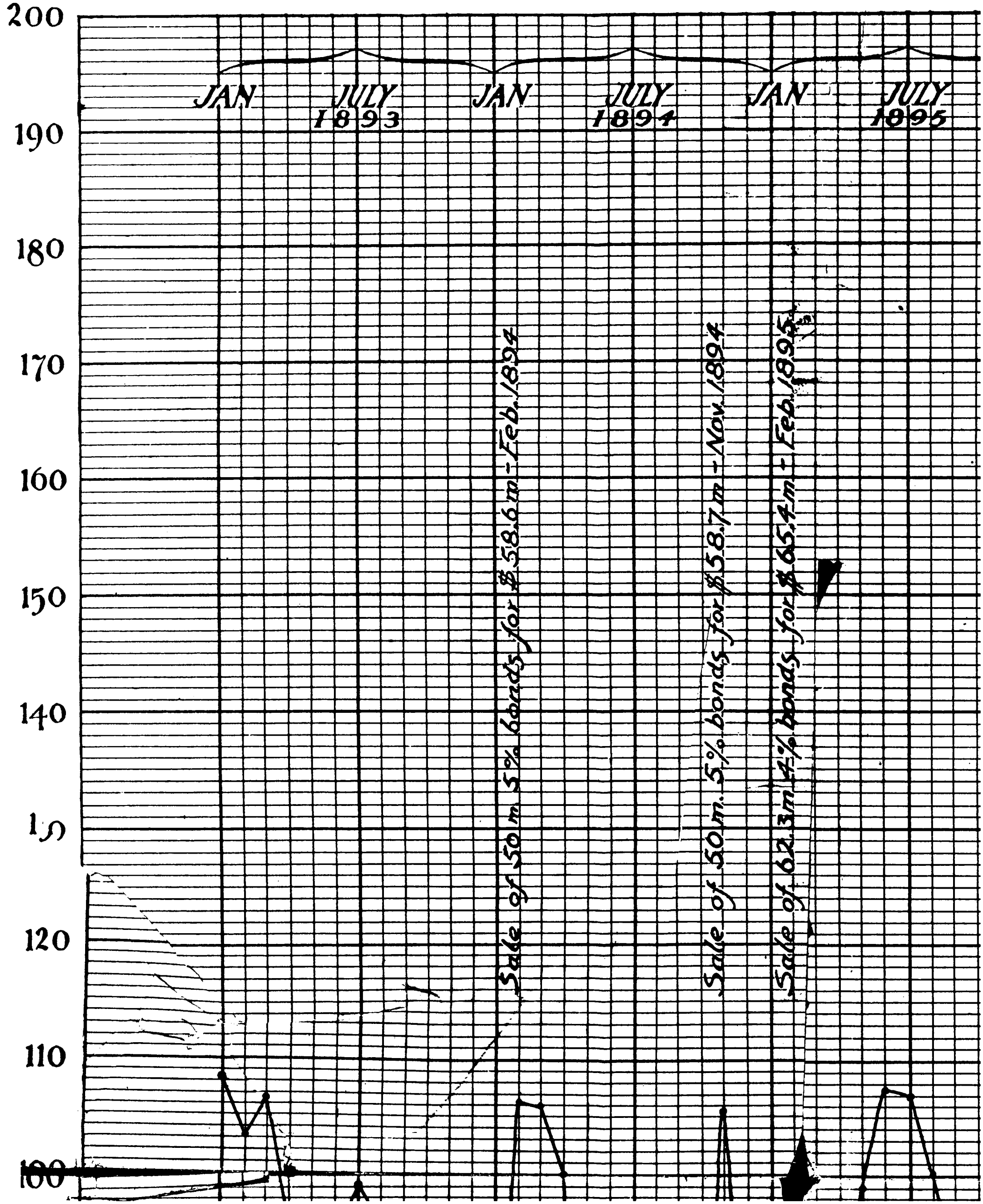
THE UNITED STATES TREASURY IN 1894–1896.*

I PROPOSE in the present paper to consider some aspects of the recent financial history of the United States, and more particularly some of the monetary operations of the Treasury during the years of depression that followed the crisis of 1893. The salient events of the period,— the struggle with a declining revenue, the continued drain on the gold holdings, the repeated danger of the Treasury's collapse, the successive loans needed to save it from virtual bankruptcy,— these are fresh in the memory of all. I wish to direct attention to one phase that has perhaps not received due attention. This is the mode in which the Treasury dealt with the outstanding legal tender notes during the years in question, and more particularly during the years 1895 and 1896. An attentive examination of this phase of the history will bring into strong light the difficulties under which the Treasury inevitably labors under our present anomalous system or lack of system, and it may also bring some light on mooted points in the general theory of money and banking.

The appended chart will make it easier for the reader to follow the movements to which I wish to direct attention. The two lines show what were the holdings of gold and of legal tender notes by the United States Treasury from 1893 to 1898. The unbroken darker line shows the holdings of gold, the dotted lighter line those of legal tender notes. In both cases the figures on which the chart is based are those of the net holdings at the close of each month. For the gold the line thus indicates the net holdings of gold coin and bullion by the Treasury, less gold certificates outstanding. For the legal tender notes the line indicates the holdings of United States

* Read at the meeting of the American Economic Association, Dec. 28, 1898.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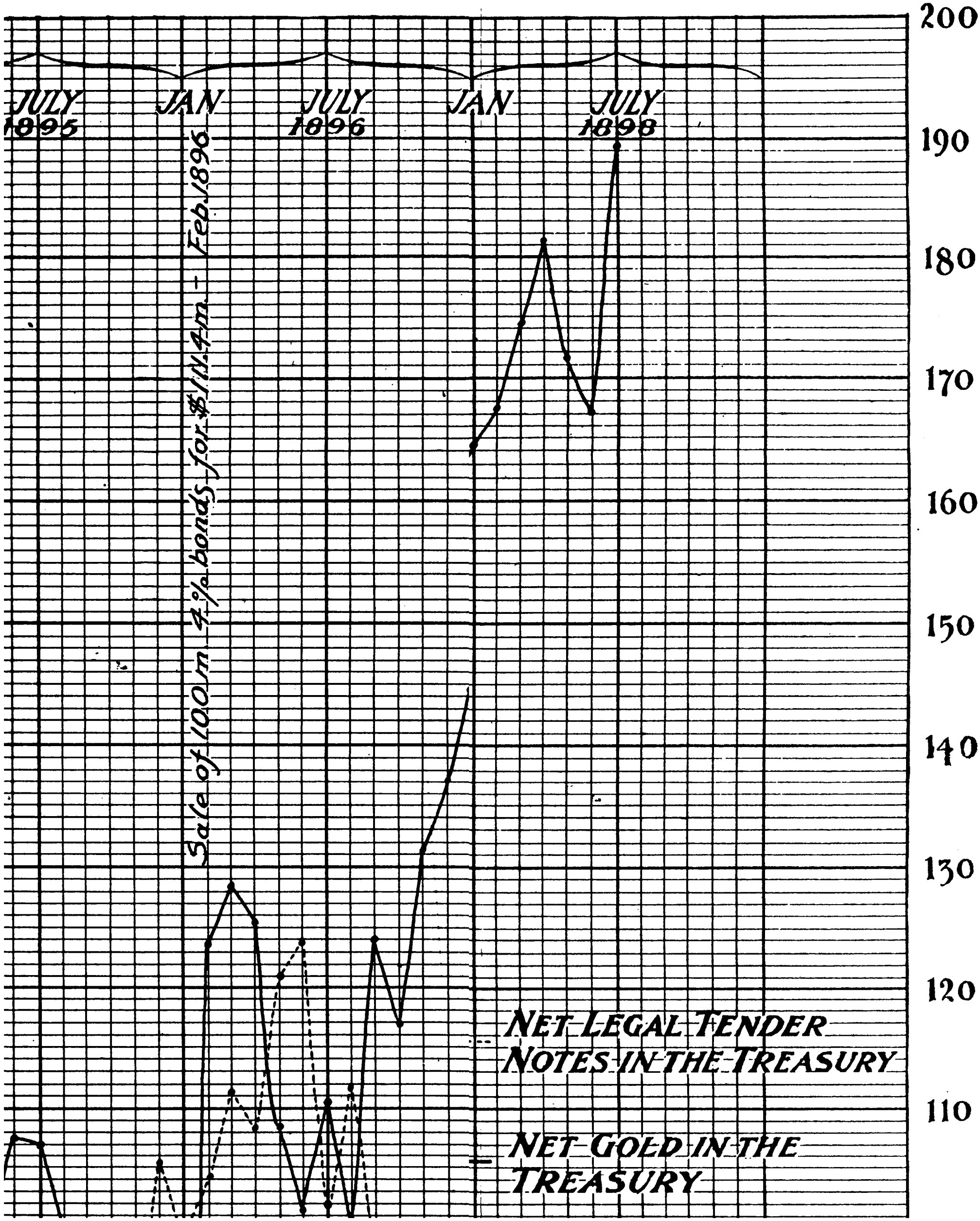
Sale of 50m. 5% bonds for $58.7m - Nov. 1894
Sale of 62.3m 4% bonds for $65.4m - Feb. 1895



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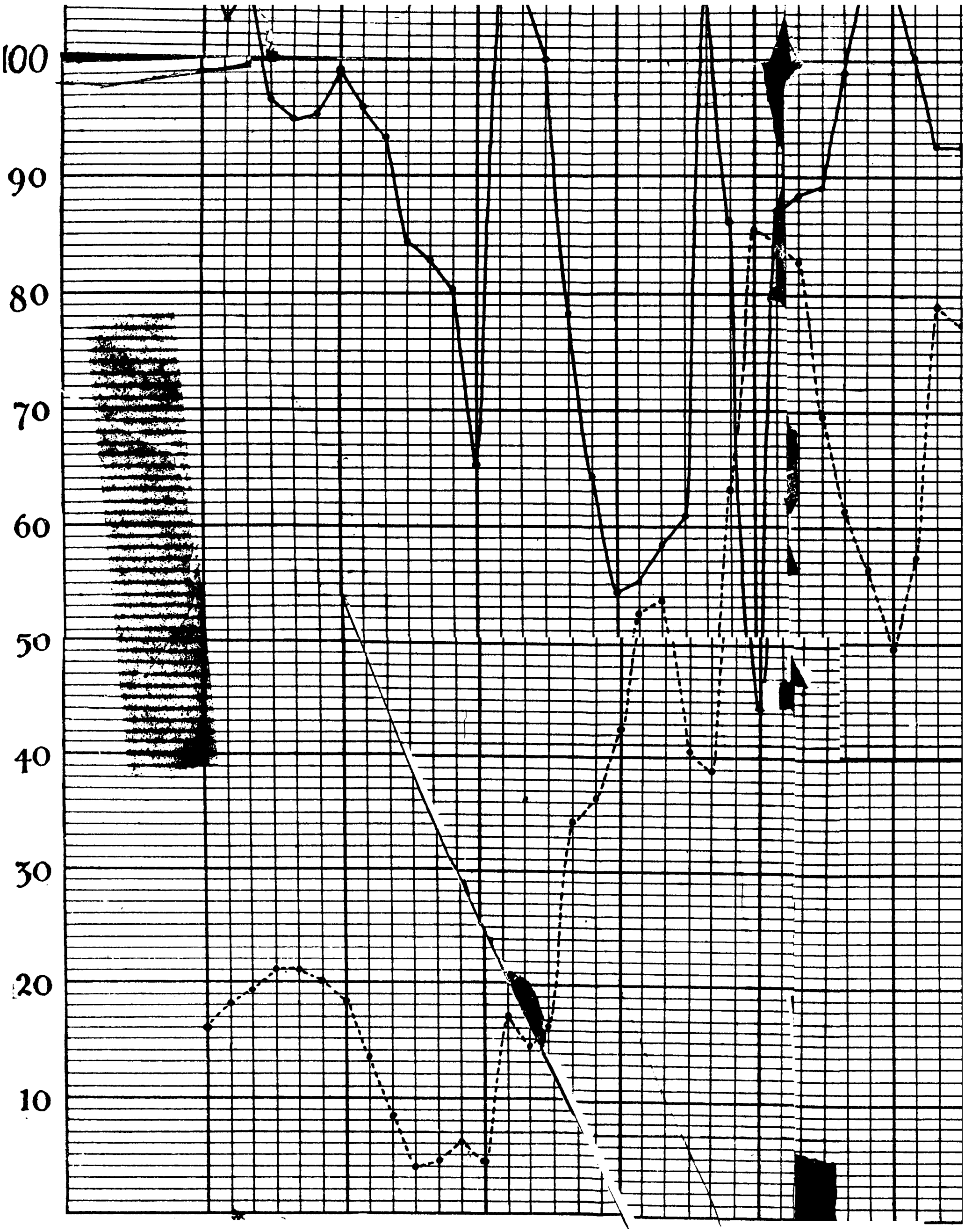
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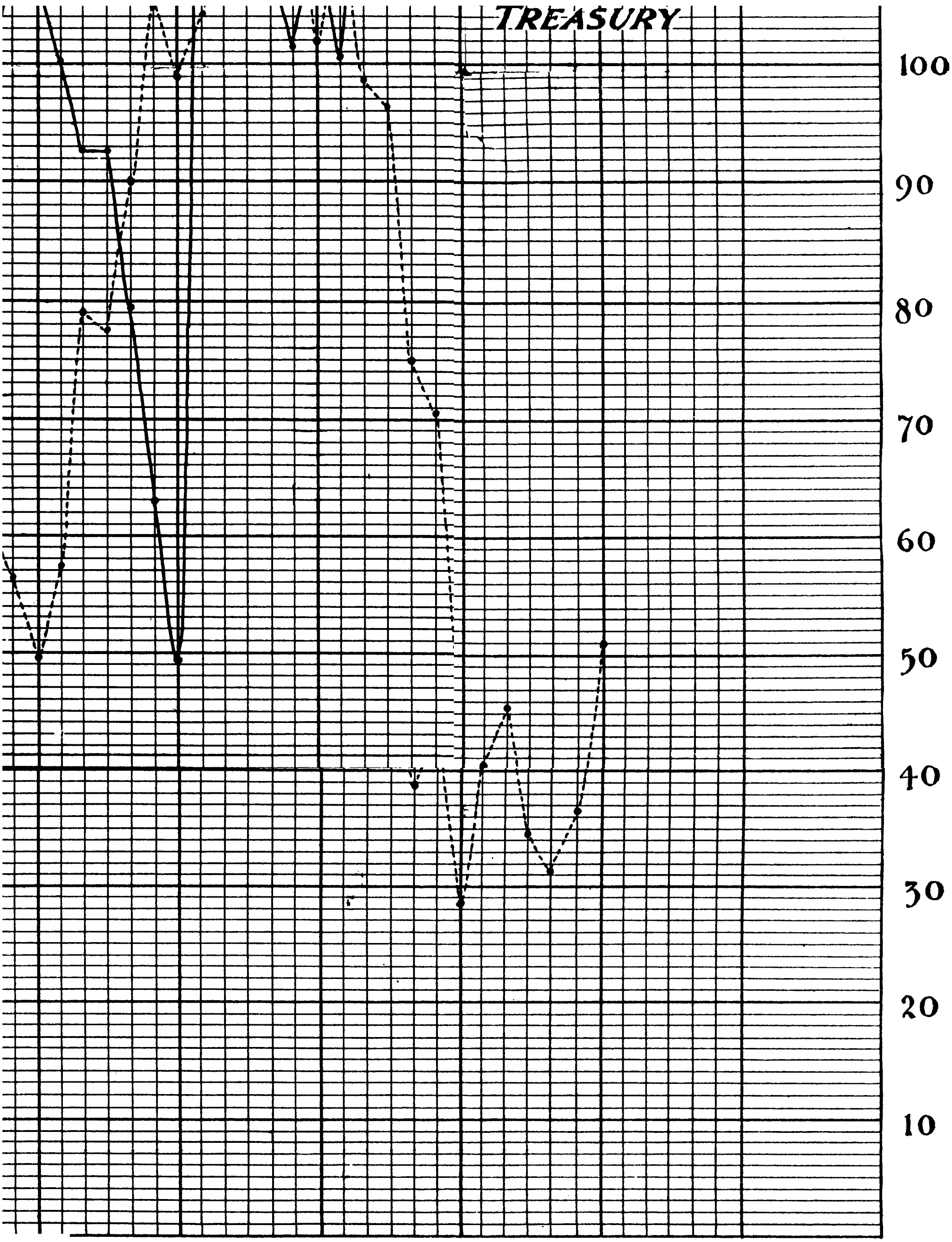
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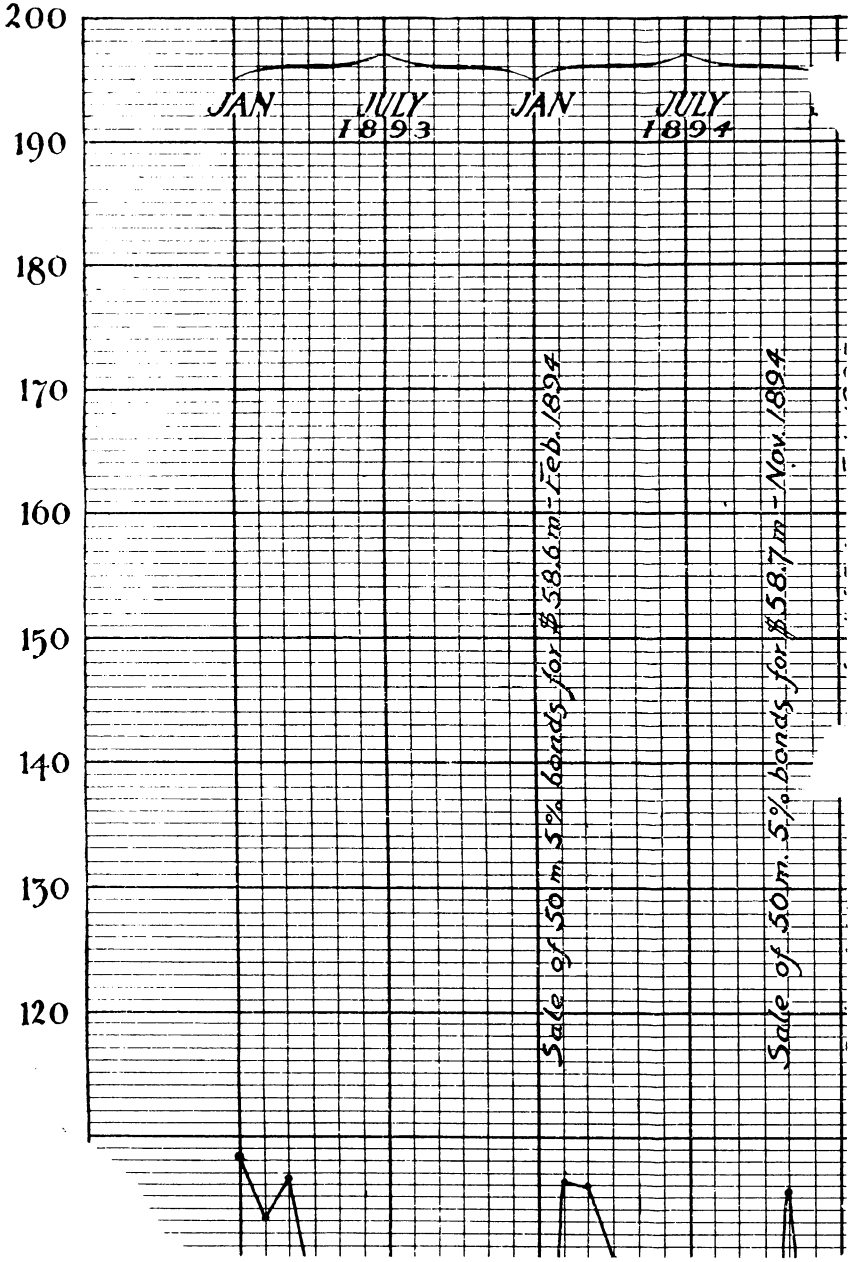

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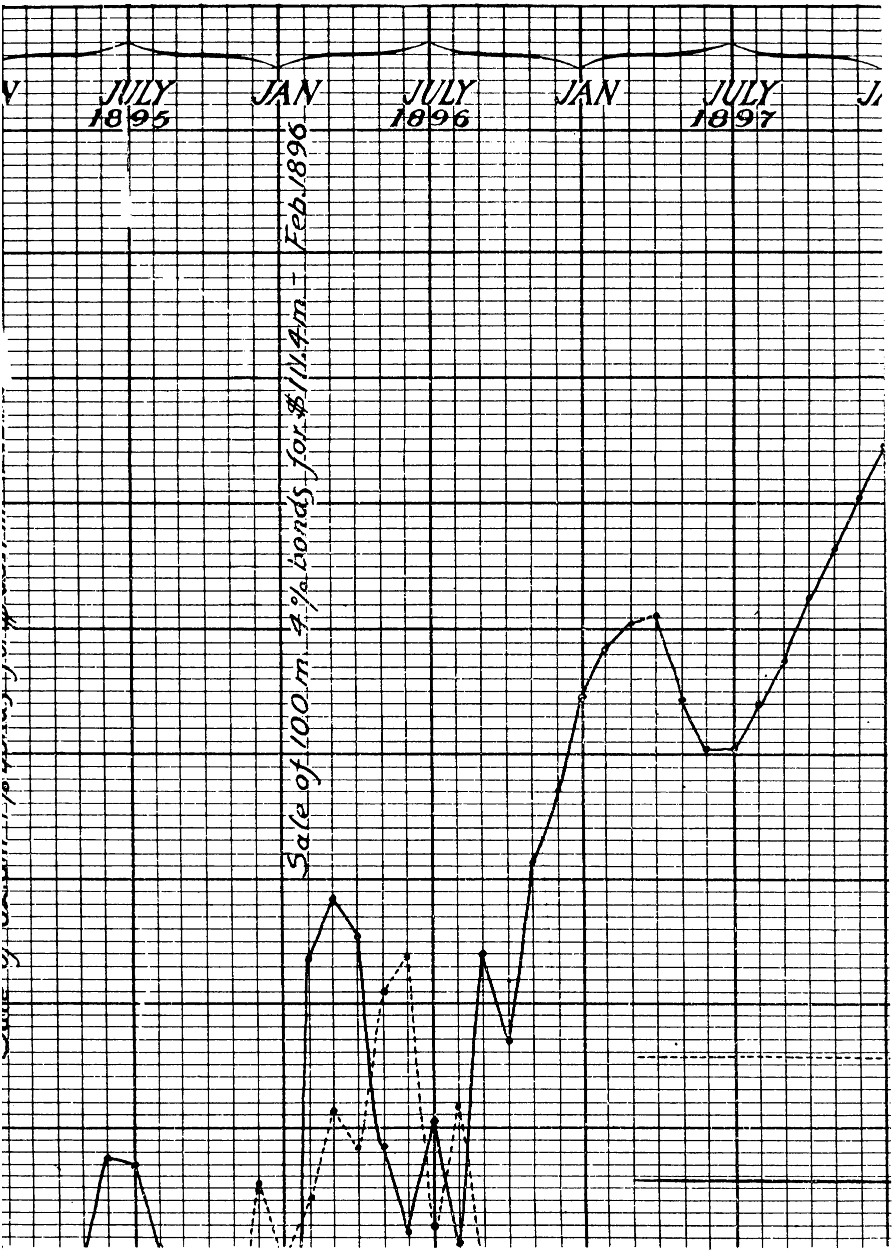
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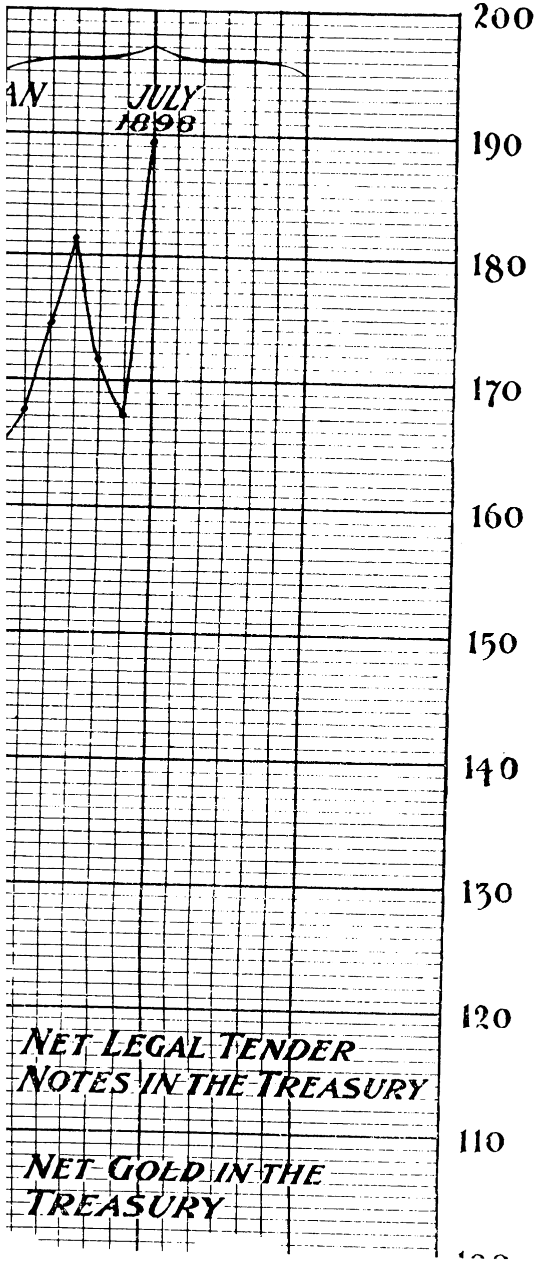

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notes and Treasury notes of 1890, less currency certificates outstanding. In the Treasury statements the two kinds of legal tenders — United States notes and Treasury notes — are commonly stated in separate columns; and care is not always taken to show that the gross holdings at any time must be corrected for the outstanding currency certificates. In constructing the chart, figures have been used which show the net legal tenders held by the Treasury. The two kinds of legal tender notes, being in almost all respects identical, have been added together for the respective dates; and the net holdings have then been made out, as in the case of gold, by deducting the amount of currency certificates held by the public.*

First, as to the gold holdings. The lines of the chart bring into sharp relief the checkered history of the Treasury in its endeavors to maintain a gold reserve. The continued drain on its holdings led to repeated depletion and to the four successive loans of 1894–96. At the beginning of 1893 the stock stood at about 100 millions. After a year it had so fallen that in February, 1894, the first loan was made by the issue of 50 millions of 5 per cent. bonds; and the stock was thus brought above 100 millions. It soon began to fall, however; and, by the close of the year (November), another loan of 50 millions was necessary, once more bringing the line on the chart above the 100 million mark. Again, and this time with a rapidity almost fatal, the stock sank; and within three months a third loan had to be made,— the much-discussed syndicate loan of February, 1895. For a while the special stipulations made in this case with the lenders, designed to prevent the dissipation of the dearly bought supply,

* Currency certificates are authorized only on the deposit of United States notes; *i.e.*, of the legal tender paper which dates from the Civil War. No certificates may be put forth against the Treasury notes issued under the act of 1890. Hence, strictly speaking, the net legal tenders in the Treasury consist of (*a*) the United States notes held, less currency certificates outstanding, (*b*) all the Treasury notes.

seemed to secure the desired end. During six months the stock remained, if not amply adequate, at least at a decent point. But by the close of 1895 and the beginning of 1896, a fourth fall took place; and in February, 1896, a fourth loan was made, this time the subscription loan of 100 millions. At last the end seemed to be attained: the gold of the Treasury, though somewhat depleted in midsummer of 1896, remained above the 100 million mark, and in the latter part of the year rose sharply. Through the following year (1897) it was steadily high, and for the time being apprehensions regarding it ceased.

Turn now to the other line on the chart. The changes there indicated, though much less noticed in general discussion, are no less significant. The holdings of legal tender notes by the Treasury undergo fluctuations as great as those in its holdings of gold. At the outset, in the beginning of 1893, the stock was small, exceptionally small. The inadequacy of the revenue of the Treasury to meet its current expenses had begun to appear as early as this, in the closing months of President Harrison's administration; and the cash on hand for ordinary expenses was at a low ebb. The stock remained small through 1893; but in 1894 it rose sharply and almost continuously, and by the opening of 1895 the Treasury held some 85 millions of legal tenders. After a decline in the first half of this year (1895) the stock again rose, passed the 100 million mark before the year was out, and remained at some such figure through the greater part of 1896. For a period of about a year — from November of 1895 to October of 1896 — the Treasury locked up in its vaults continuously the huge sum of 100 millions of legal tender notes. Not until the close of 1896 was any serious inroad made on this accumulation. Then a sudden drop took place, some 50 millions of legal tenders were let loose within three months, and the holdings shrank to dimensions still large, but not so obviously in excess of any possible requirements for current expenses.

It is to the significance of the changes in these holdings of legal tender notes that I wish chiefly to direct attention. It seems the more worth while to do so because the public documents and reports issued by the Treasury tell us singularly little on the subject. Evidently, in the fiscal year 1895–96, a very important part of the Treasury's operations was the accumulation and retention in its vaults of some 100 millions of notes. Yet, while the fluctuations in the gold stock are much discussed, those in the note holdings, though quantitatively quite as important, receive no mention. Neither in the reports of the Secretary of the Treasury nor in those of the Treasurer is there one word of reference to this striking part of the Treasury's doings. Nor is much said on the subject in the commercial and financial journals. The curious inquirer must ferret out the facts in the cumbrous statistical statements from the Treasury, and must then seek an explanation of the movement for himself.

Let us now recall some of the industrial phenomena of those years. The summer of 1893 witnessed an acute commercial crisis, which, once the fever had run its course, was followed by the usual period of lethargy and depression. During the crisis itself, cash was in eager demand, and was hoarded by individuals, by savings-banks, and, indeed, by the commercial banks themselves; for there was a partial suspension of cash payments over the counters of the banks. The form of cash which was most in demand was the legal tender note. The public was so habituated to paper money for its daily transactions that gold was little asked for; while among the banks themselves there was the additional factor that gold was expected in many quarters to go to a premium, and so was sparingly paid out. The stock of legal tender notes in the New York banks shrank from 60 to 22 millions, while that of the Treasury (as the chart indicates) became virtually nil. The breakdown in the ordinary

machinery of credit was such that cash was urgently called for by individuals, by savings-banks, by country banks; and the total of the legal tender issues was in circulation, or, at least, in use by the public.

After the crisis the equally familiar phenomenon of a plethora of money appeared. With cessation of the acute stage, and with the ensuing depression in industry, the circulating medium, swollen by the great issues of Treasury notes under the act of 1890, became excessive. The cash not needed for the current operations of trade, and no longer called for by the extraordinary demand of the crisis, flowed back to the central depositories with remarkable quickness and in remarkable quantities. By the close of October in 1893 the legal tender holdings of the New York banks once more were at 60 millions, where they had stood in the early months of the year. The accumulation continued steadily, and before the year was out had raised these bank holdings to over 100 millions. For some time thereafter, and especially during the years 1894 and 1895, the legal tender reserves were heavy, remaining for many months at a time at a figure higher than 100 millions, and rising not infrequently to 120 and 130 millions. "Money" was a drug, and the rate of discount was at the minimum.

Evidently, the movement had its effect on the Treasury, too; and the accumulation of legal tenders in its hands was part of the same phenomenon,—the redundancy of the currency. But the accumulation did not appear so promptly in the Treasury, nor did it continue so uninterruptedly; and this side of the Treasury operations deserves to be followed with more detail.

A glance at the chart will show that during the years 1894 and 1895 the Treasury holdings of gold and of legal tenders move inversely to each other. When the paper line goes up, the gold line goes down; and, when the gold line goes up, the paper line goes down. Obviously, it is

to be expected that paper should accumulate as gold is drawn out. Notes being presented at the Treasury for redemption, they take the place of gold in the Treasury cash. The converse movement is not so simple. As gold accumulates, paper shrinks,— thus in the autumn of 1894 and again in the spring of 1895. The explanation is to be found partly in the ordinary position of the Treasury with relation to the Mint and partly in the extraordinary fiscal difficulties of the Treasury during the period in question. Ordinarily, gold which is brought to the Mint, whether from domestic mines or from abroad, is paid for by Treasury checks; and these may be settled at the clearing house in legal tenders, thus causing an exchange of gold for paper in the Treasury holdings.* But, in addition, the fiscal position of the Treasury from 1893 to 1896 compelled it to pay out large amounts from its cash on hand. Current expenses then exceeded current income, and some of the paper for which gold had been paid out was used in meeting the deficit. The precise form in which this came about was that the Treasury debit at the New York clearing house was large, and that the existing stock of cash (even though it had reached the government vaults through gold redemptions) had to be drawn on to pay the balances. The notes so paid out were turned into the already surcharged reserves of the New York

* "In ordinary times and under ordinary circumstances there is a natural flow of gold towards the Treasury, which is often limited only by the capacity of the Treasury to carry the specie. The product of our mines finds its way to the Mint, where it is paid for by checks; and these are presented at the counters of the sub-treasuries or through the clearing house in New York, as currency obligations. The result is an increase of the gold reserve and a diminution of the available balance of notes and silver certificates. Gold imported in the form of bullion or foreign coin takes usually the same course.

"Besides these two sources of ordinary gain to the gold reserve, there is another in the direct exchange of paper currency for the coin, where the paper is preferred for its greater convenience. Fortunate, indeed, has it been for the Treasury that, even during the most critical periods through which the country has recently passed, these currents of inflow have not been altogether checked." *Report of Treasurer of the United States*, 1896, p. 9.

banks. The plethora of money in New York made it easy for borrowers to secure loans, and then draw out cash (*i.e.*, legal tenders) without effect on the discount market or on foreign exchange. Whenever the balance of international payments caused gold to flow from the country (as happened to be frequently the case during this period), the legal tenders thus readily obtained were presented at the Treasury, and gold was so secured for shipment abroad. The same plethora made it easy for the timid or the speculative to secure cash for a "run" on the Treasury; and such a run, in the form of sudden and heavy demand for the redemption of paper in gold, took place, it will be remembered, in the first weeks of 1895, leading to the abrupt and much-criticised bond syndicate loan of February, 1895. Here we have the "endless chain," not simple, but intricate, having for its links the Treasury's duty to maintain gold payments, the fiscal deficit, the redundancy of the currency, the adverse balance in the country's international trade, and the general uneasiness bred by the repeated distress of the Treasury.

In 1896, however, the Treasury situation changes in one regard, at least. The great loan of February, 1896, when 100 millions of 4 per cent. bonds were sold for 111.4 millions of dollars, brought up the gold holdings once more. But now the legal tender holdings, which had risen to large amounts as paper had been redeemed by the Treasury, remain intact: they do not fall as the gold rises. It is not to be doubted, even though the Treasury reports are silent on the point, that this was the result of a deliberate policy. The heavy loans had brought in resources sufficient not only to meet the deficit in current expenses, but to impound a great quantity of legal tenders. Impounded accordingly they were to the amount of 100 millions and more,— locked up and put out of harm's way. Something of this sort had indeed been done in previous

years. In 1894 and in 1895 the redeemed legal tenders had not been paid out *in toto*. Considerable amounts had been kept after each successive loan; and the Treasury holdings had accordingly crept up gradually, though irregularly. In 1896 this impounding of the redundant paper was maintained deliberately, firmly, and on a large scale. As has already been noted, for nearly a year — from November, 1895, to October, 1896 — the Treasury held steadily a hundred millions, more or less, of its own paper. Nor is it to be doubted that this procedure contributed largely to the attainment of the desired object,— the protection of the Treasury's gold holdings. The retention in the Treasury vaults of so great a quantity of legal tenders, coupled with the maintenance of the gold holdings at about the same amount, prevented excessive accumulation in the banks. The reserves of the New York banks, whether of paper or of gold, shrank to more moderate dimensions.* The loan market became firmer; and it was less easy to draw out legal tenders, whether as a means of getting gold for shipment abroad or for speculative operations.

With the autumn of 1896 a new turn in the Treasury

* The cash, or "reserve," held by the associated banks of New York at certain dates in 1893–96, was as follows: —

	Legal Tenders.	*Specie.*
October 3, 1893	44.3	80.3
December 19, 1893	96.5	103.5
February 24, 1894	110.0	97.5
May 4, 1894	127.4	100.1
July 18, 1894	130.3	91.0
October 2, 1894	114 6	92.0
December 19, 1894	100.4	72.1
March 5, 1895	87.5	69.6
May 2, 1895	89.2	69.7
July 12, 1895	111.1	64.3
September 28, 1895	97.9	61.7
December 13, 1895	81.6	67.5
February 28, 1896	86.5	60.3
May 2, 1896	84.5	59.5
July 14, 1896	86.2	62.3
September 26, 1896	72.0	54.3

situation takes place, marking a new turn in the industrial situation. A last glance at the chart will show that the legal tender holdings fall rapidly and heavily in the closing months of 1896; while those of gold rise sharply, though not in complete correspondence with the decline in the paper. The fortunate events of that period are fresh in the memory of all, and their consequences still affect the condition alike of the Treasury and of the country. The failure of crops in Europe and the abundance of harvests at home changed almost every aspect of the monetary situation. Heavy exports caused gold to flow in from abroad, and much of this found its way into the Treasury.* Large crops and good prices for cereals caused a flow of money to the West and a draft on the cash holdings of the New York banks. The same conditions led to a general revival of activity, at first slow and hesitating,—as is common under such circumstances,—and gradually stronger and surer. Hence the Treasury was able, not only to gain gold in one way and another, but to pay out legal tenders without any danger of their flowing back. Some of the links in the endless chain had now disappeared. The balance of international payments was no longer against the United States. Partly in consequence of the same causes that led to this fortunate change, the paper that was paid out by the Treasury was no longer obviously redundant. On the contrary, it was absorbed largely by shipments to the West, and remained in active circulation. Hence it was possible to meet the still-continuing deficit by paying out part of the accumulated legal tenders without encountering the ominous backflow of the previous years. A gleam of prosperity thus brightened the closing months of the second Cleveland administration,—too late to redeem it from association with depression and disaster, and only in time to enable it to turn over the Treasury in flourishing condition to its fortunate successor.

* See foot-note to p. 209 above.

We need not follow the course of events further. In 1897 the same conditions prevailed as in the latter part of 1896,—swelling exports, inflow of specie, revival of industry. The Treasury gold rose, its legal tenders stayed out. With 1898 the fiscal operations arising from the Spanish War affect the situation again, and open still another chapter in our financial history. The chapter which deals with the events consequent on the crash of 1893 closes with the year 1897, and we may proceed now to consider some of the lessons to be derived from our survey of those events.

First, as to questions of monetary theory. In the early decades of the century Tooke and his associates had maintained that convertible bank notes *per se* could not raise prices, their circulation being a consequence, and not a cause, of speculative activity and rising prices. But, they said, inconvertible paper and convertible paper issued by a government might be expected to have a different effect, since the mode of issue was different,—not by loan, but in the way of expenditure,—while the possibility of reflux was either absent or much weakened.* It may be a question whether so sharp a distinction can be maintained. No doubt it might be plausibly argued that the heavy issues of government paper in the Treasury notes of 1890 caused or at least bolstered up a régime of speculation and of sustained prices in 1890–92; but it would not be easy to prove that an equal issue of strictly convertible bank-notes would have had no effect or a less effect. I question whether a clear difference in effect could be satisfactorily proved in any specific case, still more whether any difference in degree could be even roughly measured. But, when we come to the other side of the movement,—the effects of currency issues in periods of depression,—the recent experiences of the

*See Tooke's *History of Prices*, vol. iv., part iii., chap. ii., especially sections 5, 6 (pp. 183–200).

United States may be set down as instructive, showing, as they do, that, when the down grade is reached, government issues are as powerless as bank issues to check the descent. Experience has amply shown that the greatest freedom and temptation among banks to extend their convertible note issues cannot prevent prices from falling during a period of sluggish industry, as, indeed, is also proved to be the case with their use of deposits. Abundant government paper is equally impotent. Elsewhere I have pointed out how the silver issues — dollars and certificates — under the act of 1878 followed rather than led the oscillations of industrial activity and of prices in 1879–89.* It might be suggested that these silver issues were ineffective because of the limitations on their availability,— the bulk and inconvenience of the actual dollars and the absence of legal tender quality in the certificates. But in recent years we have had another experiment with a kind of money which might be expected to do the utmost of which any paper based on specie was capable,— legal tender notes, issued in any desired denominations, and freely available and availed of in bank reserves as well in every-day circulation. Yet, clearly, they were unable to stem a tide of depression and of falling prices. The legal tenders so plentifully held by the banks and by the Treasury in 1894–96, and recurrently paid out, have flowed back into these reservoirs with a persistency almost fatal to the Treasury. Put forth by the government in its ordinary disbursements, they have come back into its hands in unmanageable quantities, until finally the only mode of maintaining the specie basis was to submit to the necessities of the case, and store away the redundant paper. And when, in the fall of 1896, they were paid out and stayed out, the change evidently was due to changed industrial conditions. The sudden turn in export trade

* *The Silver Situation in the United States*, pp. 72 *et seq.*

at that time caused an immediate call for currency for the crop regions, soon followed by a more permanent demand arising from a general revival of industry. The circulation of the legal tender paper, like that of the silver, has followed, not preceded, the decline in business activity, in speculative operations, in prices.

I will not undertake to discuss the wider questions in the theory of money suggested by these experiences. If convertible legal tender notes are thus — for some time, at least — impotent to stem a falling tide due to other forces, does the same hold good of inconvertible notes? And, if so, what becomes of the good old principle that the range of prices depends on the quantity of money? I apprehend that it will not be impossible to answer these questions or to fit the phenomena here under review into a properly grounded and properly qualified statement of the traditional theory. In its foundations that theory seems to me still sound; but it needs to be fitted to the great changes which the civilized world has gone through during the past hundred years. Thus an issue of inconvertible notes or a great increase of specie does tend to raise prices,— nay, it may sometimes be predicted, will raise prices; but by a mechanism slower in its operation and more uncertain as to the quantitative result than the common versions lead us to expect. Whether there are differences in rapidity as well as in certainty of operation between inconvertible and convertible paper, and again between convertible paper and specie,— these are more delicate questions, on which perhaps it is idle to expect a precise answer either from theoretical reasoning or from actual experience. But in any case it is certain that there are prolonged periods during which the actual and effective circulation of convertible notes, and of inconvertible notes and specie as well, is a consequence rather than a cause in the general working in the mechanism of exchange.

The second lesson to which this survey of our recent experience leads is a more obviously practical one,— the need of legislation that shall prevent the recurrence of the misfortune of 1894–96. The system or lack of system in our monetary legislation remains the same, and what has happened before may easily happen again. If it be suggested that this is but a remote possibility, the answer is that the experiences of 1894–96 do not stand alone. Much the same thing happened a decade before; and it may not be amiss to recall the less conspicuous, but no less instructive, events of that earlier date.

In the years 1884–86 the silver currency then being put forth under the act of 1878 led to phenomena almost precisely similar to those of 1894–96. There had been activity and speculation in 1880–83; and during that time the silver currency, though not always easy to manage, had on the whole found ready circulation. With the failures and reverses of 1884, it became redundant, precisely as the legal tenders (inflated as these had been by the issues under the act of 1890) became redundant in 1894. Then, also, the silver was hoarded and tucked away in the Treasury vaults, as the legal tenders were in 1896. That the one form of currency was so handled at the earlier date, the other at the later, does not affect the nature of the operation. In 1884–86 the silver certificates, partly because they were restricted to the larger denominations (none under $10 until 1886), did not readily make their way into circulation, and hence tended to flow back into the Treasury. They were thus the form of currency which the Treasury was led to impound. In 1894–96 almost all of the silver certificates had been changed to small denominations, and were absorbed in the every-day circulation, whereas the legal tenders, inflated by the issues of 1890, were redundant, and, being presentable for direct redemption in gold, were a more obvious source of danger for the Treasury. Hence it was now their turn to be hoarded.

In one important respect, to be sure, the conditions of the earlier period were different from those of the later, and were more fortunate. The ordinary operations of the Treasury then yielded a surplus, and not, as in 1894–96, a deficit. Consequently, the excessive silver currency could be stowed away with comparative ease. I may be permitted to quote what I have said elsewhere in describing the operations of 1884–86: —

> In the eighteen months between the beginning of 1885 and the middle of 1886 the government received over twenty-six millions in silver certificates which it did not reissue ; paid out in addition some thirty-six millions for silver bullion which was coined into silver dollars, and in that form stowed away in the Treasury vaults; and materially increased its net holdings of gold. These enormous sums, of course, represent an excess of income over outgo. Notwithstanding the decline in its receipts as compared with earlier years, the government still had a surplus so large as to enable it to hoard sixty millions of silver currency and to add twenty-five millions to its holdings of gold. . . . In the financial history of any other country such a surplus would be considered a rare piece of good luck. We had it for so many years that we did not fairly realize what risks it enabled us to run without coming to grief.*

These same risks we continued to run, and we came to grief. In large part the same operations were carried on in 1894–96 as in 1884–86. Only in the later period there was no surplus in the ordinary operations of the Treasury, while the complications from the general business crisis were more severe. By successive violent measures — the four large bond sales — the last stage of disaster was avoided. The bond sales yielded not only enough to make up the deficit on current account, but an available surplus; and thus a round 100 million of legal tenders could be hoarded by the Treasury. When activity revived in 1886–87, the silver which the Treasury had accumulated could be let out with safety, and made its way

* *The Silver Situation in the United States*, p. 32.

into active circulation; and so, when activity revived in 1896–97, the hoarded legal tenders could be let out with safety, and made their way for the time being into active circulation.

What has thus happened twice already may easily happen again. The volume of paper and silver for which the Treasury is responsible remains huge, and its means of dealing with the mass are not sensibly improved. The oscillations in industrial activity will continue, and a volume of currency which is in active use at one time will prove redundant at another. A surplus in the Treasury may indeed enable a well-disposed executive to tuck away part of the excessive circulation for a time, and so give an artificial elasticity; but by what disturbing methods and with what uncertain results the history of the last twenty years amply teaches. In any case a continued surplus in the Treasury is equally undesirable and improbable,— undesirable, in that it tempts to extravagance; improbable, since both the special sources of the federal revenue and the oscillations of business activity make alternations of lean and fat periods inevitable. The statement, often heard, that the only thing needful in the way of currency legislation is to provide the Treasury with a surplus, indicates a sadly inadequate appreciation of the difficulties of the existing situation. Much more should be aimed for: in what direction and by what legislation has been repeatedly pointed out in the many projects for reform, strikingly similar in their essentials, which have recently been pressed on Congress. Let us hope that a clearer understanding of what has taken place under the existing conditions may lead to the adoption of measures for permanent betterment in those conditions.

F. W. Taussig.